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## ASIA-PACIFIC ECONOMIC SURVEYS: PAPUA NEW GUINEA

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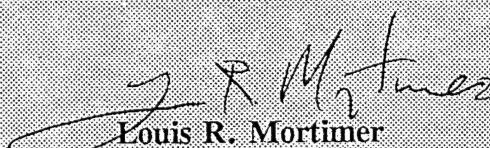
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## ASIA-PACIFIC ECONOMIC SURVEYS: PAPUA NEW GUINEA

### SUMMARY STATEMENT

Papua New Guinea is a country beset with numerous economic problems. Since it became independent in 1975, successive governments have struggled to establish a self-sufficient and stable economy. Twelve years later this policy is in danger because the country still lacks adequate stable domestic sources of revenue. Social factors are the key cause of this economic malaise. More than 50 percent of the population is illiterate, and more than 40 percent depend on subsistence agriculture to earn a living. Government officials responsible for advising the people on education and development are believed to have too many duties and too little expertise. In an effort to overcome these weaknesses, the government has been encouraging foreign companies to help develop Papua New Guinea's mineral resources. The success of this effort has enabled the government to maintain a low rate of economic growth in the 1980s.

Nineteen-eighty-seven fiscal policies focus on reducing social programs and external borrowing, but the government also wants to increase spending on rural and infrastructural programs. In the parliamentary elections held in June and July 1987, continuation of government support for the agricultural sector was the single most important issue. Prime Minister Paias Wingti's political coalition presently has a three-seat majority in parliament; therefore his chances for remaining in power are largely dependent on how much progress his administration makes in balancing the budget and reducing the external debt.

Perhaps because of its economic problems, the Wingti Government has adopted policies designed to promote closer bilateral relations with Australia. In September 1987, the two nations signed a new agreement that will strengthen their already close defense relationship. Australia's economic and military assistance is an important, although declining, part of the Papua New Guinea budget.

### AVERAGE ANNUAL GDP GROWTH IS TWO PERCENT

The most recent year for which statistics are available on Papua New Guinea's gross domestic product (GDP) is 1985. In that year, Papua New Guinea's total GDP was about US\$2.4 billion. According to a 1987 Papua New Guinea Government report, GDP grew 4.4 percent in 1985. This figure is based on constant purchasers' values using 1981 as the base year.

The average annual increase in GDP for the 4-year period from 1981 to 1985 was 2.2 percent.

Agriculture accounts for about one third of GDP. The market and non-market components of this sector are about the same, meaning that one half of all agricultural production in Papua New Guinea is consumed in the locality where it is produced. Eighty-five percent of the population live in small villages, and almost all rural households grow some of their own food.

The mining and manufacturing sectors each accounts for about 10 percent of GDP. Prospects for growth in the mining sector are considered excellent, particularly since Papua New Guinea is known to have large, untapped reserves of gold, oil, and copper. However, manufacturing is unlikely to grow appreciably in the late 1980s because the private sector lacks many entrepreneurs and the government is not inclined to invest in this sector.

Public utilities (electricity, gas, water, and sanitary services), transportation and communications, and construction together account for less than 10 percent of GDP. In many areas of the country, the residents do not have electricity, indoor plumbing, or access to telephones. The road network is poorly developed. Only 3 percent of the country's 19,200 kilometers of roads are paved. Most construction projects are small and are intended to raise the standard of living of targeted urban and rural communities.

Government and social services comprise almost all of the remaining one third of GDP. The central and 19 provincial governments provide a variety of health, education, and financial services to the general public.

#### GOVERNMENT RESTRAINTS SPENDING TO REDUCE EXTERNAL DEBT

The 1987 budget reflects the need for fiscal restraint, providing for US\$1.08 billion in revenues and expenditures and emphasizing a reduction in foreign borrowing. The budget represents a nominal increase of 3.2 percent over the 1986 total, but since inflation is running about 6 percent, a real decrease of 2.8 percent. Education, social programs, and urban development projects were cut, but the government increased assistance to the agricultural sector. For example, the government doubled the funds provided in 1986 to the Agricultural Bank to be used for low-interest loans to small landowners and cooperatives. Funding for targeted hydroelectric and other infrastructural projects also was retained because the government considers these programs essential to its long range development goals. Although current information on the external debt is not available, it

is known that as Australian aid has decreased in recent years, national leaders have been unable to make up the difference from domestic sources of revenue and have been forced to use overseas commercial borrowing to balance the budget. This policy increased Papua New Guinea's total external debt from US\$611 million in 1980 to US\$1.7 billion in 1984. Improvements in export earnings have helped the country meet its debt-service obligations. In 1985, the country paid US\$180 million in debt-service payments, and the debt-service ratio as a percentage of exports was 13.7 percent. In 1987, US\$185 million was budgeted for debt-service payments.

The government is hoping that tax reforms instituted in late 1986 will generate additional revenue from domestic sources. In 1986, 61 percent of the budget was derived from internal revenue, and the government plans to increase this amount to 68 percent in 1987 and totally eliminate overseas commercial borrowing. While these goals appear overly optimistic and may not be reached in 1987, in the long term such measures should help to reduce the country's deficit. Papua New Guinea must increase domestic revenue in proportion to the amount of Australia's reduction of foreign aid, which in 1987 was reduced by 6 percent to US\$185 million. The number of taxpayers is slowly increasing, and the government anticipates taxes paid by individuals will generate US\$270 million in revenue in 1987, or 4 percent more than in 1986. The government also anticipates increases in revenue from corporate taxes, particularly from the mining sector.

#### BALANCE OF PAYMENTS SITUATION IMPROVING

Increases in the export of key agricultural items and minerals in 1985 resulted in the first balance of payments surplus in five years. Gold, copper, coffee, cocoa and forestry products were the principal exports in 1985 and together they accounted for almost two thirds of all exports which totalled US\$959 million. Increases in gold and coffee production were particularly significant in turning a 1984 US\$64 million deficit into a 1985 US\$41 million surplus. This trend continued in the first six months of 1986 with Papua New Guinea showing a \$US37 million trade surplus for that period.

Manufactured goods, motor vehicles, and fuels were the most important imports in 1985; together they accounted for about two thirds of all imports, which totalled US\$918 million. Papua New Guinea's domestic manufacturing industries are limited primarily to food processing, furniture, and metal fabrication. The development of new plants is hampered by the small and fragmented domestic market, the shortage of persons with entrepreneurial and

managerial skills, and the high cost of labor relative to productivity. Although a number of foreign companies are currently exploring for oil and gas in various parts of the country and its territorial waters, as yet none of these ventures have proven commercially feasible. However, the nation's demand for motor vehicles and fuel is increasing and this trend is likely to continue into the 1990s.

Australia, Japan, Singapore, West Germany, New Zealand, the United Kingdom, and the United States are Papua New Guinea's most important trade partners. In 1984, about half of the country's imports came from Australia. Japan, Singapore, New Zealand, and the United States provided most of the remaining 50 percent. In the same year, 30 and 24 percent of exports went to Japan and West Germany, respectively. The United Kingdom, Australia, and the United States were the third, fourth, and fifth largest importers, respectively. Trade between Papua New Guinea and Communist countries is negligible.

#### LOW EDUCATION AND HIGH UNEMPLOYMENT CONTINUE TO HURT ECONOMY

The literacy rate is low, even by Third World standards. The national literacy rate is 42.3 percent, 52.4 percent for males and 31.3 percent for females. Of the population over 15, about 70 percent have had no formal schooling. According to an independent report on the economy conducted in 1985 under the auspices of the Development Studies Center of the Australian National University in Canberra, it will be difficult for Papua New Guinea to increase its economic self-reliance until this situation improves. In 1987, missionaries operate six times more schools than the government and there are no laws requiring children to attend schools. The literacy rate is also a major factor in the country's unemployment problem.

At most, only 40 percent of the country's 3.4 million people are employed. Because of the poor educational system and the lack of an entrepreneurial class, the country must depend largely on foreigners to invest in and manage new businesses. It is estimated that 72 percent of professional and semiprofessional positions are held by expatriates. The World Bank, and other sources, have recommended that Papua New Guinea seek foreign assistance to improve this situation, but the government has done little to resolve the problem.

Another significant economic problem is the inability of the central government to set national standards for the quality of services and development assistance provided to the provinces. The 1985 Australian National University study concluded that many of the provinces have too much control

over programs and too few qualified people to effectively carry out national policies. As a result, the quality of the programs provided in the provinces varies. Because Papua New Guinea has one of the most heterogeneous populations in the Pacific region, many local leaders are reluctant to grant more authority to the central government.

#### UNITED STATES COMPANIES INVOLVED IN GOLD MINING

Gold is the most significant commodity imported by the United States from Papua New Guinea. In 1984, it accounted for more than 90 percent of all US imports from that country. In 1987, a joint US-Australian exploration project discovered new gold reserves on the eastern island of Lihur that could increase the country's gold production from around 35 tons a year to about 75 tons a year by 1992. Several American companies are involved in the exploration of mineral and oil resources, and US interest in the commercial development of such resources is increasing. Most US exports to Papua New Guinea are manufactured goods, particularly mining equipment. The government offers inducements in land and taxes to attract foreign investment in agriculture and in other sectors of the economy. However, few Americans appear to be interested in investing in industries not associated with mining.

#### DEFENSE SPENDING DOWN SLIGHTLY IN 1987

In 1987, Papua New Guinea spent US\$34.5 million on defense, or about 3 percent of the total budget. Although this amount is about the same as the 1986 allocation, with the 3.2 percent increase in the budget and inflation running about 6 percent, the figure adds up to a real decline of about one half of 1 percent. Government leaders and budget officials probably justified the decreased spending based on the assessment that the Indonesian border situation will remain stable and projections that there are no other external threats to the country.

The armed forces comprise an army, navy, air force, and border police. The army has 2,846 personnel and is organized into 2 infantry battalions, 1 engineer battalion, 1 signal squadron, and several small logistic units. The navy has 300 personnel and approximately 10 naval vessels. These are not sufficient for patrolling its 3,795-kilometer coastline. The air force has 86 personnel and a variety of obsolescent aircraft that are primarily used to patrol the border with Indonesia. The border police force has 4,600 personnel.

Relations with Indonesia improved with the signing of the October 1986 Treaty of Mutual Respect, Friendship and Cooperation. The agreement includes a non-aggression clause and provisions for cooperation on the issue of the insurgent Free Papua Movement. In 1984, more than 9,000 refugees crossed into Papua New Guinea from the Indonesian province of Irian Jaya because of operations by the Indonesian Army against the Free Papua Movement. The potential for conflict between the two countries focuses on the 12,000 Indonesians who live in Papua New Guinea refugee camps along the border. Many of these refugees have refused repatriation and continue to call for an end to Indonesia's control of Irian Jaya.

Papua New Guinea leaders are believed to have signed the September 1987 defense agreement with Australia because the country needs additional assistance in patrolling its long coastline and cannot afford to increase defense spending. Australia is the country's largest supplier of military equipment and most of the latter's military officers are trained in Canberra. Although details of the agreement have not been publicly disclosed, it will probably provide for an increase in Australia's air and naval surveillance in areas belonging to and contiguous to Papua New Guinea.